

Service Date: October 18, 2004

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF the Statement)	UTILITY DIVISION
of Factors for Evaluating Proposals)	
to Acquire NorthWestern Energy.)	DOCKET NO. N2004.10.166

**STATEMENT OF FACTORS FOR EVALUATING
PROPOSALS TO ACQUIRE NORTHWESTERN ENERGY**

Introduction

The Montana Public Service Commission (PSC) has been asked over the months about factors which it might use to evaluate a sale or transfer of the NorthWestern electric and gas systems. This document sets forth a general response, based primarily on applicable law, regulations, judicial decisions, and the Commission's experience from participating in the NorthWestern Chapter 11 bankruptcy, and must be understood in the context of the bankruptcy. It is intended to provide all interested parties neutral, transparent and consistent information. This document is not intended to chill the advancement of any prospective purchaser of NorthWestern that can demonstrate its ability to provide adequate service at reasonable rates. It is not intended to prejudice any issues that will come before the Commission or bind future commissioners as they discharge their duties under law. This list of factors was developed by PSC commissioners and staff, and acted on at an open meeting, but is not the result of a Montana Administrative Procedure Act (MAPA) contested case or rulemaking.

As it has in the past, the PSC will assert under its general supervisory powers its authority to review any sale or transfer of NorthWestern's Montana operations. Any sale or transfer will require PSC approval. A proceeding would be conducted under then-applicable Montana law, MAPA contested case provisions and PSC procedural rules.

The NorthWestern/PSC/Montana Consumer Counsel Settlement Agreement, dated July 8, 2004, in the bankruptcy (bankruptcy settlement) proceeding is binding on any successor company and represents the foundation for an acceptable acquisition.

Statement of Factors

The Commission seeks a stable, consumer-focused, utility-focused, and Montana-focused provider of electric and natural gas distribution, provider of last resort, and other related services, regardless of the corporate identity or the form of organization.

Based on the PSC's experience, a superior acquisition proposal and acquirer is likely to have a preponderance of these elements and characteristics:

Financial strength and capability

- Acquirer should be a financially stable, investment grade utility. Relative financial strength, capability and credit rating are desirable in order to discharge utility responsibilities in a cost effective manner.
- Ability to own and operate the system based on rates that do not include recovery of any acquisition price paid above depreciated net book value (an acquisition adjustment) or that do not exceed rate levels which exclude an acquisition adjustment, while fully complying with the requirement of a revenue requirements case to be filed by September 30, 2006 based on a 2005 historic test year, and providing adequate service (as further referenced in this document).
- Commitment and ability to comply with "ring fencing" provisions of the bankruptcy settlement and PSC order in the financial investigation (Consent Order 6505e in Docket D2003.8.109) or, through use of the process described at Paragraph 9 of the settlement agreement, a specific, enforceable proposal for equally rigorous structural and non-structural affiliate protections.
- A binding commitment to fund the pension plan at a level not below NorthWestern's current funding forecast. That forecast is for an annual funding level of \$19.2 million to \$19.7 million in the years 2005 through 2008.
- Commitment to long-term ownership of the utility.

Energy supply

Financial and management ability to acquire an appropriate electricity supply under the Commission's guidelines [ARM 38.5.8201 – 38.5.8229] and to complete the electric default supply portfolio (similar to "provider of last resort" obligations in some other restructured states). This is the utility's most important unfinished business. The current exposure to the short-term market represents an unacceptable level of price risk.

- A commitment to develop a balanced portfolio under the guidelines, including demand-side and renewable resources as well as conventional hydro and thermal resources.
- Utilize robust competitive RFP processes and contracting practices to establish credibility, ensure broad access to potential resources, and enhance wholesale market competition for the benefit of Montana customers.
- Eligibility for Bonneville Power Administration preference power could be a benefit.
- Similarly, an acquirer should be able to plan and implement an appropriate portfolio approach to its natural gas default supply obligations, taking into account both low price and price stability.
- Familiarity with Western electric grid and Western wholesale market conditions.

Infrastructure

- A binding commitment to fully implement the Liberty Consulting infrastructure (gas and electric transmission and distribution) audit recommendations. This is necessary to maintain and enhance system integrity and reliability.

Demonstrable Montana focus

- Ideally, this would occur through a Montana headquarters of either the company or a separate Montana utility subsidiary. A Montana headquarters would reflect the relative importance of the Montana operations and its long-term commitment to a successful Montana utility. Based on Commission experience, management of the utility is most effective when located where the company has the majority of its business. Such a focus should certainly improve morale for employees and result in better communications with the Commission.
- Ideally, there would be no operating ties to South Dakota or Nebraska. Sale of NorthWestern's operations in the other states would accomplish a Montana focus. An acceptable, but less preferable, Montana focus might also be achieved through a commitment of management, personnel and financial resources to the Montana operation.
- The Commission acknowledges economies of scale and scope, as well as sometimes more favorable access to capital that may be, but are not necessarily, associated with larger firms.

Utility focus

- Many terms of the bankruptcy settlement agreement are designed to avoid repeating the diversification mistakes of the recent past, which were devastating to shareholders and potentially harmful to customers. Risk should not be inappropriately transferred to customers.

Customer focus

- Strong and demonstrated customer focus, including by meeting or exceeding the Commission's customer service and service quality standards (generally, ARM 38.5.1401-1418 and 38.5.1101-1112).

Energy utility management experience

- The bidder should have strong utility management experience and expertise. The complexity of assembling the default supply portfolio for the electric and gas utility is one of many examples which demonstrate the need for talented and experienced utility management skills. Implementing the Liberty Consulting infrastructure audit is another example of the challenges faced by management of this utility far into the future.

Effective functioning in the Montana constitutional, statutory, and regulatory framework

- The Commission seeks a stable, consumer-focused, utility-focused, and Montana-focused provider of electric and natural gas distribution, provider of last resort, and other related services, regardless of the corporate identity or the form of organization.
- Understanding of and a commitment to constructive professional relationships with key stakeholders such as the Montana Consumer Counsel, commercial and industrial customers, low income and senior citizen organizations, environmental organizations, and competitive suppliers.
- Direct interaction between key utility employees responsible for operations and the Commission's staff and other stakeholders. Outside counsel performs a valuable role, but is not a substitute for direct communication on technical and operational matters.
- Familiarity with and commitment to the public purpose provisions of the Universal System Benefits Programs, as set out in Montana law.

- Any vertical reintegration should be consistent with then-applicable Montana law, based on an orderly plan, and provide for effective and transparent PSC regulation of rates and services.

Relevant documents

- Title 69, Montana Code Annotated
- Bankruptcy settlement agreement dated July 8, 2004
- Consent Order 6505e in Docket D2003.8.109
- Liberty Consulting final audit report dated July 2, 2004
(<http://psc.state.mt.us/eDocs/CurrentInterest/pdf/FinalReportNWE7204.pdf>)
- Initial response of NW to Liberty Audit dated August 30, 2004
<http://psc.state.mt.us/eDocs/CurrentInterest/pdf/NWEMPSCLibertyResponse.pdf>
- PSC default supply procurement guidelines (ARM 38.5.8201-8229)
- NW portfolio plan (<http://www.montanaenergyforum.com/>)
- PSC 8/17/04 Comments on NW portfolio plan – Docket N2004.1.15
(<http://psc.state.mt.us/eDocs/CurrentInterest/pdf/N2004115PSCComment.pdf>)

DONE AND DATED this 14th day of October, 2004 by a vote of 5 to 0.

BY THE MONTANA PUBLIC SERVICE COMMISSION

BOB ROWE, Chairman
THOMAS J. SCHNEIDER, Vice Chairman
MATT BRAINARD, Commissioner
GREG JERGESON, Commissioner
JAY STOVALL, Commissioner